Exhibit IV-5:
Self-Dealing and Internal Dealing in First-Run Syndicated Programming (2004)

TYPE OF TRANSACTION	HOURS	
	All Shows	**Shows Less Than 2 Years Old**
Self-Dealing (Subsidiaries of Big 5 syndicating to themselves)	32%	61%
Internal Dealing (Subsidiaries of Big 5 syndicating to Big 3 station groups)	41	16
Independents syndicating to Big 3 Station Groups	18	0

Sources and Notes: Calculated from Goro Oba and Sylvia M. Chan-Olmstead, "Self-Dealing or Market Transaction?: An Exploratory Study of Vertical Integration in the U.S. Television Syndication Market," *Journal of Media Economics,* 19 (2), 2006, p. 113.
Big 3 station groups are CBS/Viacom, Fox and ABC
Big 5 syndicators are King World, Paramount, 20th Century Fox, Buena Vista, WB and Universal. Other Major is Sony (Columbia). Independents are "other."
There are 22.5 hours per week of first-run syndicated programming in the 9am to 8pm day part analyzed (77 hours).

The foreclosure of the broadcast/network television market, particularly for 1st run series, is reinforced by a complete lack of pilots coming from independents. Interviews with independent producers done for this paper reveal that since there is little chance that they will get on the air, they have abandoned this market.

I have noted that the decision to allow broadcasters to hold multiple licenses in a single market contributed to the difficulties of independents gaining access to the syndication market. The network owners would use their internally produced content on the television stations in the largest markets, squeezing the space available to unaffiliated producers. About 75 duopolies were created soon after the ban on holding multiple licenses was lifted. The national networks concentrated their duopoly acquisitions in the top ten markets, even though owning multiple stations within a market did not count against the national cap on how many homes they were allowed to reach. These markets account for about 30 percent of all the TV households in the country and almost 40% of all the TV revenues in the country. The big four network's market share in the top three markets was particularly high. These three markets alone account for about 15 percent of the population and almost 20 percent of TV revenues in the nation.

Exhibit VI-6:
Big 4 Network Duopolies and Market Share in Top 10 Markets

Designated Market Area	*Number of Big 4 Duopolies*	*Market Share Big 4 Duopolies*	*Total Market Share of Big 4*
New York	2	44	77
Los Angeles	3	62	79
Chicago	2	40	73
Philadelphia	1	25	57
San Francisco	2	37	56
Boston	1	28	42
Dallas	3	59	59
Washington D.C.	1	27	52
Atlanta	0	0	24
Detroit	1	24	42

Source: BIA Financial, *Television Market Report,* 2003

TV Movies, The Role Of Cable

The history of prime time programming is primarily a story about television series. While a small number of made for TV movies appear in prime time, the overwhelming majority of programming is series. Interestingly, for independents, the growth of cable in the late 1990s was a story about TV movies.

To analyze the changing patterns of TV movies, I examined all films aired in three four-year periods (see Exhibit IV-7. The first period was before the Fin-Syn rules were in play (1985-1988). The second period was the four years after Fin-Syn was repealed (1995-1998). The third period was after the networks became integrated with studios (2001-2004).

Exhibit IV-7:
TV Movies Across All Distribution Channels

	Percent of Movies		
	Broadcast	*Basic Cable*	*Premium Cable*
1985-1988 (n=47)			
Independent	39	0	2
Network	47	2	2
Majors	9	0	0
1995-1998 (n=206)			
Independent	33	13	16
Network	18	1	5
Majors	11	0	2
2001-2004 (n=634)			
Independent	7	41	9
Network	5	20	7
Majors	5	5	1

Source: Baseline Beta Studio System Database.

I relied on the baseline database and included only movies that were aired and for which a network and at least one producer was identified. Where a network was listed as a producer, the movie was considered to be produced by the network, even if other (unaffiliated) producers were identified. This is the critical assumption in the sense that I am assuming, implicitly, that the movie would not have been aired on the network, but for the network's interest in the co-production. Of lesser importance is the assumption that where a network and its major movie studio are both listed as producers, the studio was considered to be the producer. While these distinctions could be interpreted in other ways, the basic patterns in the data would not change much. The key findings about independent producers are quite clear (as shown in Exhibit IV-7).

The pattern of broadcast movies follows the pattern we observed for series. The independents played a large role under Fin-Syn, were diminished immediately after the repeal of Fin-Syn and then reduced dramatically within a decade. Their share in premium movies grew in the mid-1990s, but was reduced after the integration of the studies.

In the most recent period, cable movies have become quite prominent. The numbers of movies produced have increased dramatically. In the mid-1990s, independents aired about 120 movies, 95 of them on broadcast and premium cable. In the 2001-2004 period, they produced over 100 movies on broadcast and premium cable, and over 260 on basic cable. The apparent increase in production, however, is less significant than it appears. There are two different sets of reasons that the expansion has not helped independents greatly. One set has to do with the nature of the business and the distribution channels.

First, broadcast and premium movies have much higher budgets and larger audiences. Thus, the 100 movies produced by independents that aired on broadcast and premium cable probably had a substantially larger total budget and a larger audience than the 260 movies that aired on basic cable.

Second, where studios compete for resources to maintain a production base, the relative output is important. Whereas the independents grew by about 6 percent between the mid 1990s and the early 2000s in the high value spaces, the networks and major studios grew by almost 60 percent. As the networks grew larger and larger, they control more resources in the sector.

Third, placement on basic cable makes it more difficult to tap into other revenue streams – DVD sales/rentals and foreign television – which have become vital to maintaining the program's prominence.

The second set of factors that suggest the growth of basic cable as an outlet is less important than it appears has to do with the market structure.

First, approximately 80 percent of the basic cable movies aired in the 2001-2004 period on networks is now owned by two of the vertically integrated media corporations – ABC/Disney (ABC family, Disney Channel and Lifetime) and NBC (Sci-Fi).

Second, the genres are highly specialized. These cable networks buy three genres, each with a respective dominant buyer. ABC Family/the Disney Channel buy family/children-oriented movies. Lifetime buys romances. Sci-fi buys science fiction films. This is a classic situation for the exercise of monopsony power.

Third, the vertically integrated oligopoly that dominates the other video outlet spaces also thoroughly dominates the TV movie space. The five entities I have identified as the vertically integrated oligopoly account for about three-quarters of the distribution of movies: one-third through broadcast and premium cable, a little over one-third through basic cable, and another handful on general networks (A&E, MTV, ESPN, FX, Spike).

ACCESS TO TELEVISION IS CRUCIAL TO THE HEALTH OF INDEPENDENT PRODUCERS

Thus, I have shown that the independents were largely eliminated from prime time broadcasting and relegated to basic cable movies. This places the independents at a severe disadvantage because television and the broadcast space at the core of the vertically integrated oligopoly remain extremely important to the overall market for video product. Exhibit IV-8 presents order of magnitude estimates of the revenues, expenditures and audiences for domestic movie producers and the domestic TV sector. It contrasts cable and broadcast revenues with to sources of revenue for movie producers that are 'independent' of the domestic TV sector – domestic and foreign theatrical releases and home video sales.

Exhibit IV-8:
The Importance of Television in the Video Entertainment Product Space (circa 2003-2004)

	MOVIES		TELEVISION		
	Majors	**Independents**		**Broadcast**	**Cable/ Satellite**
Revenues (Billions)					
Domestic			Ad Revenue/ Subscription	$35	$50
Box Office	$ 8.0	$1.0			
Home Video	11.0	1.3			
Subtotal	19.0	2.3			
Foreign					
Box Office	8.0	1.0			
Home Video	8.0	.8			
Subtotal	16.0	1.8			
Total	38.3			85	
Programming Budgets (Billions)	7.0	.4		$40	
Audience (Hours Per Year)					
Theatrical	13		Broadcast	780	
Home Video	80		Basic		830
Total	93		Premium		180

Sources: U.S. Box Office and Programming budgets are based on MPAA, *Theatrical Market Statistical Report, 2005.* Programming budgets do not include marketing and assume 120 releases from the majors. Foreign Box Office, home video and TV revenues are from David Waterman, *Hollywood's Road to Riches* (Cambridge: Harvard University Press, 2005), Table C.1. Independent programming budgets from American Film Marketing Association, *The Economic Impact of Independent File Production,* April 2003Cable Revenue is from Federal Communications Commission, *Twelfth Annual Report in the Matter of Annual Assessment of the Status of Competition in the Market for the Delivery of Video Programming,* MB Docket No. 05-255, March 3, 2006, p. 19.

The revenue from the TV sector is much larger than the domestic revenue sources for the movie industry – about four times as large – even when video sales/rentals are included. Total revenues from these sources are over two times as large. Even if we were to factor in the domestic and foreign TV revenues of movie producers, the domestic TV sector would be almost twice as large.[27]

Programming expenditures of the domestic TV sector are on the order of five to six times as large.

The extreme importance of TV in terms of audience is also clear. Broadcast and cable pull almost twenty times the audience of movies, even combining theatrical and home video viewing. Premium cable (arguably similar to movies since it is a pay service) alone has a larger audience.

Although basic cable and broadcast are about equal in audience, prime time broadcast is still the dominant exhibition space on TV. For example, the advance sales of advertising slots on the four national networks – called the up front sales – equals the total annual Box Office of theatrical releases in the U.S. Advertisers pay a rich premium for this space because the networks still aggregate many more viewers than cable shows. As Mara Einstein, the author of the most comprehensive analysis of the repeal of the Fin-Syn rules noted, the gatekeeper role of the networks is essential since,

> while the networks must decide between best show versus best buy, they remain acutely aware of their ability to provide something that no other media vehicle can, and that is the ability to create a valuable asset because no medium can provide the kind of exposure and promotion that network television does.[28]

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[27] The sources cited in Exhibit IV-8 put this revenue at about $8 billion.
[28] Einstein, Mara, *Media Diversity: Economics, Ownership and the FCC* (Mahwah: Lawrence Erlbaum, 2004), p. 192.

The networks are well aware of their advantage. As Les Moonves recently put it, "If you want 30 million people, you can't get that anywhere else."[29] The next chapter examines how that gatekeeper role impacted access to distribution under the new policies adopted in the 1990s.

[29] Fabricant, Geraldine and Bill Carter, "A Tortoise Savors the Lead," *New York Times*, September 12, 2006, p. CC11.

V. THE IMPACT OF MARKET STRUCTURE ON INDEPENDENT PRODUCTION

THE CRITICAL ROLE OF GATE KEEPING IN THE VIDEO PRODUCT SPACE

At the center of the picture I have painted of vertical integration following the policy decisions of the 1990s stand the broadcasters as gatekeepers of access to audiences. A key role in the process was played by the absorption of the major studios. Interestingly, David Waterman's recent economic history of the major studios is based on the premise that

> the most important feature of the studios is their role as *distributors,* and we often refer to them by that term. By controlling distribution, the studios act as gatekeepers: they decide which movies get produced and how they are made, and they also largely determine when and at what price viewers get to see them on which media.[30]

The key gate keeping role of distribution in the video entertainment product space was integrated and consolidated with production in single entities in the first 50 years of the movie industry. While there is a debate about the factors that shaped the role of the major studios, Waterman pinpoints two critical issues that parallel the core of my analysis of the video product space in the 1990s. One was a policy decision that forced deintegration.

> Fox, MGM, Warner, Paramount, and RKO, known at the time as the five majors, were vertically integrated into production and theater exhibition and had consistently dominated the industry since the mid-1930s. The three others – Universal, Columbia and United Artists, known as "the minors" at the time – owned no theaters… All eight of these studios were brought to trial by the U.S. Justice Department in the 1940s, and an eventual Supreme Court decision in 1948, *United States v. Paramount Pictures, Inc. et al.*, ruled that the eight distributors had violated the Sherman Act and other antitrust laws… The Court ordered the five major distributors to divest their extensive theater holdings… established a number of regulations on contractual relationships between

[30] Waterman, David, Hollywood's Road to Riches (Cambridge: Harvard University Press, 2005), p. 16.

> distributors and theaters that were incented to level the playing field for independent companies.[31]

The second factor that shaped the market for theatrical movies was the growth of television.

> After the *Paramount* decision, the prewar stability of industry structure among the eight Paramount defendants began to crumble. Industry positions of the majors and the minors converged, and the extent of independent entry increased. We argue in the following chapter that the almost coincident diffusion of television has more profound long-range effects on the movie industry than did *Paramount*, but it is likely that ascendance of all three of the minor studios into the majors ranks, and perhaps the rise of independents in the 1960s, were related to the Court's intervention.[32]

Thus, the policy of forcing deintegration of production and distribution of theatrically released movies opened the door to entry, while the advent of television created a whole new channel for the distribution of video product. Waterman reckons that the technological factor played a large part in shaping the video entertainment space, although not so much in determining concentration as in altering the types of products the sector produced and the marketing patterns of those products. However, from the point of view of the analysis in this paper, the critical point is that the convergence of the same two factors – integration policy and multiple distribution platforms – that worked to weaken the gatekeeper role of the studios in the 1950s, worked in the opposite direction for the broadcasters in the 1990s. Removing the policy restriction on vertical integration opened the door to reintegration of the production and distribution of video product and the merger of production (studios) and distribution (broadcasting and cable). The lesson is clear: if given the chance, entities will merge and integrate vertically in order to dominate the sector by controlling distribution.

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[31] Waterman, p. 30.
[32] Waterman, p. 23.

Mara Einstein, already described above as conducting the most thorough investigation of the Financial Interest and Syndication rules, notes that before and after the policy limiting vertical integration the broadcasters used their control over access to audiences to monopolize ownership of network programming.

Before the Fin-Syn rules were in place, networks asserted ownership over prime-time programming.

> In the 1970s, what led the FCC to institute the financial interest and syndication rules was a concern that the networks were becoming both too powerful and too demanding when it came to the [program] selection process. Too powerful in that they were the gatekeepers of news, information, and entertainment for the American public. This was so because of the limits of radio spectrum... Too demanding, because networks were requiring an equity stake in a program before it would be accepted as part of the prime-time schedule.... [T]he networks had ownership of more than 70% of their prime-time schedule by the mid-1960s, up from only 45% the previous decade. The strong arming of producers was a fundamental reason for the creation of fin-syn.[33]

The timing is informative. TV arrives on the scene in the 1950s and becomes the dominant medium by the early 1960s. In the early days, broadcasters lacked both production capacity and market power to self-supply content. Once television achieved ascendance, the broadcasters used their resources and leverage to assert ownership over prime time programming.

The broadcast networks also had a history of antitrust problems in their role as gatekeepers of access to the television audience. In 1978 they lost an antitrust case that paralleled the *Paramount* case.

> In the *Unites States v. National Broadcasting Co.,* The government specifically accused the National Broadcasting Company (NBC) of restraint of trade as it related to purchasing programs from independent producers and of using its

[33] Einstein, Mara, *Media Diversity: Economics, Ownership and the FCC* (Mahwah: Lawrence Earlbaum, 2004), p. 179

> network power to monopolize prime-time programming production of shows broadcast on the network. The Department also claimed that NBC, with CBS and ABC, was trying to develop a monopoly over the television programming market.[34]

After a twenty-year period in which the networks were restrained by the Fin-Syn rules, the broadcasters moved to reassert ownership in prime-time programming once the rules were repealed.

> Since the rules were repealed in 1995, the economic structure of the industry changed drastically. The television networks have become vertically integrated institutions with the ability to produce programming through internal business units. Corporate parents put pressure on the networks to purchase programming internally to achieve synergies and, of course, increase profits. Being part of large media conglomerates, there is added pressure on the networks to be profitable so that Wall Street may find the parent company appealing.[35]
>
> The networks each have at least a 50% stake in the programming on their air and some have as high as 70% and even 90%.[36] The networks could never achieve those kinds of ownership numbers without requesting a stake in the programming that appears on their air. It is no secret to anyone that the networks do this.[37]

In the previous section I have noted the evolving pattern of behavior by the broadcasters in asserting ownership of prime time programming. Bielby and Bielby have argued that network behavior was political, as well as economic, and noted the evolving nature of their rhetoric. At first the broadcasters argued that the independents would not be squeezed out. Later they argued that independents were irrelevant.

> The network executives' initial position was that independent producers would thrive in a deregulated industry and that network ownership was not a threat to creativity and program quality. Increasingly, in recent years, network executives and deregulation advocates have taken the position that their opponents' positions are irrelevant, because they are out of touch with the

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[34] Einstein, p. 60.
[35] Einstein, pp. 179-180.
[36] Einstein, p. 217, citing Mermigas, 2002,
[37] Einstein, p. 217.

> realities of the marketplace. In effect, they are saying, vertical and horizontal integration were necessary for the industry to survive in the face of rising costs and increased competition from new technologies.[38]

As this process unfolded, the impact was felt in more than just access to audiences. The leverage that the vertically integrated core of the industry acquired also dramatically changed the terms of trade between the independents and vertically integrated conglomerates. With a small number of vertically integrated buyers and a large number of much smaller product sellers, the core oligopoly gains monopsony power. They can impose onerous terms on the supplier, appropriating maximum surplus. With all of the major distribution channels under their control, the vertically integrated oligopoly can slash the amount they are willing to pay for independent product.

MARKET STRUCTURAL IMPACTS OF HORIZONTAL CONCENTRATION AND VERTICAL INTEGRATION

The pattern of behavior and structural changes in the industry should raise red flags for public policy. One major concern about vertical mergers is that the industry undergoes a rush to integration and consolidation. Being a small independent firm at any stage renders a company extremely vulnerable to a variety of attacks.

> Oligopolies often settle down into behavioral patterns in which price competition atrophies, even though some or all sellers suffer from excess capacity. Non-price rivalry then becomes crucial to the distribution of sales. One form of nonprice competition is the acquisition of downstream enterprises, which all else (such as prices) being equal will be purchased from their upstream affiliates. If acquisition of this sort deflects significant amounts of sales, disadvantaged rivals are apt to acquire other potential customers in self-defense, and reciprocal fear of foreclosure precipitates a bandwagon effect in

[38] Bielby William T. and Denise D. Bielby, "Controlling Prime Time: Organizational Concentration and Network Television Programming Strategies," *Journal of Broadcasting & Electronic Media,* 47: 4 (2003), p. 585.

> which the remaining independent downstream enterprises are feverishly sought.[39]

> If there are 10 nonintegrated firms and only one of them integrates, then little affect on competition might occur. But if this action induces the other 9 to do the same, the ultimate impact of the first "triggering" move may be large. Any increase in market power is magnified.[40]

A second, related concern about vertical integration that arises from the observed behaviors is that it can create or reinforce barriers to entry into the industry. By integrating across stages of production, incumbents may force potential competitors to enter at both stages, making competition much less likely. "[V]ertical mergers may enhance barriers to entry into the primary industry if entrants must operate at both stages in order to be competitive with existing firms and if entry at both stages is substantially more difficult than entry at one stage".[41]

Capital market hurdles are only one of the barriers to entry that vertical integration and conglomeration can create. Such mergers can also foreclose input markets to competitors.

> When all production at a level of an industry is "in-house," no market at all exists from which independent firms can buy inputs. If they face impediments or delays in setting up a new supplier, competition at their level will be reduced. The clearest form of this is the rise in capital a new entrant needs to set up at both levels.[42]

The experience in the video product space over the two decades in which the vertically integrated oligopoly emerged suggests that vertical integration increased barriers to entry into the television sector.

> [B]ecause the vertically integrated structure creates such a barrier to entry… it is not necessary for these executives to collude…. The complexity has made it

[39] Scherer and Ross, pp. 526-527.
[40] Shepherd, p. 290.
[41] Perry, p. 247.
[42] Shepherd, pp. 289-290.

> almost impossible for new players to enter the market, because they have to do so on so many levels – production, distribution, cable outlets, and so forth.[43]

> Compared to recorded music, production costs in television are astronomical, creating substantial barriers to entry to new program suppliers and creating incentives to the networks to demand greater control over costs.... In the increasingly deregulated business environment, the enhanced market power of the corporations that control access to channels of distribution has made it more difficult for independent suppliers of new television series to survive in the industry. Moreover, the high cost of producing episodic television makes it extremely difficult to operate through channels of distribution outside of network television, such as first run syndication or cable (especially when those off-network venues are increasingly controlled by the same corporations).[44]

FAVORING AFFILIATES

The gatekeeper role translates into leverage because "with increased vertical integration, independent producers have less access to audiences, or they must align themselves with studios or networks to get their shows on the air."[45] Einstein concludes that integration favors internally produced product.

> Given vertical integration and the combined network/programming departments, all things being equal, an internally produced show is going to get an airing over one in which the network does not have an interest. It is also more likely to get a better time slot and be kept on the air longer. While it is possible that some shows of lesser quality are given preference over those produced by outsiders, this is a situation that is not likely to be sustained.[46]

> Producers claim that with the demise of the Fin-Syn Rules, networks have used their enhanced market position in several ways to gain unfair advantage over outside program suppliers. First, they claim that when selecting series for the prime-time schedule and deciding between a series from an outside producer versus one of comparable or even less quality produced in-house by the network or by a network joint venture, the network will favor the series in

[43] Einstein, p. 217.
[44] Bielby and Bielby, p. 341.
[45] Einstein, pp. 180-181.
[46] Einstein, p. 194-195.

> which it has a financial interest. Moreover, many producers perceive that this kind of favoritism has intensified in recent years.[47]

Exclusive and preferential deals for the use of facilities and products compound the problem.

> The first firms to integrate into neighboring stages reduce the number of alternative sources for other firms at either stage. This "thinning" of the market can increase the costs of market or contractual exchange. Subsequent integration by other firms then becomes more likely.[48]

Concerns arise that not only will the dominant firm in the industry gain the leverage to profitably engage in anti-competitive conduct, but also the dynamic processes in the industry will clearly shift toward cooperation and coordination rather than competition. The issue is not simply collusion, although that is clearly a concern.

> The *Guidelines* do recognize three major competitive problems of vertical mergers in concentrated industries. First, forward mergers into retailing may facilitate collusion at the manufacturing stage by making it easier to monitor prices or by eliminating a "disruptive buyer." [49]

Beyond collusion, a mutual forbearance and reciprocity occurs as spheres of influence are recognized and honored between and among the small number of interrelated entities in the industry.

> Now we consider the big picture, rather than market-by-market effects. Imagine an extreme situation, with five big diversified firms extending into all major sectors. They coexist in parallel, touching one another in hundreds of markets. Whatever their effects on each market might be, they pose a larger problem of spheres of interest, or diplomatic behavior replacing competition …
>
> Reciprocity is an exchange of favors. Reciprocal buying is one form of it. At its simplest, firm A buys from firm B because of some purchase that B makes from A …

[47] Bielby and Bielby, p. 581.
[48] Perry, Martin, "Vertical Integration: Determinants and Effects," in Richard Schmalensee and Robert D. Willig (Eds.) *Handbook of Industrial Organization* (New York: North-Holland, 1989), p. 247.
[49] Perry, p. 247.

> Reciprocity: The large conglomerate may have numerous opportunities for reciprocal buying arrangements.
>
> Mutual forbearance: More generally (it is sometimes claimed) large firms treat each other with deference, avoiding competitive confrontation whenever possible.[50]

Einstein and others identify a number of ways in which vertical integration affects the flow of programming. Clearly inferior shows are aired primarily because the vertically integrated media conglomerate owns them, although there is a difference of opinion on how prevalent this outcome is.

> There are already many examples of network-produced programs that have failed miserably. Shows that were put on the schedule for no other reason than the network studio produced them.[51]
>
> There is definitely favoritism for internally produced shows over those produced out of house... There are limits to this.... To the extent that they won't put on a bad show that's produced internally over a good show that's not, but certainly if two shows are of equal value the internally produced show will get the nod.[52]
>
> Indeed, according to one producer, a network financial stake in a proposed series "practically guarantees" a slot in the prime-time schedule... "Without question, if I know that I am gonna lose, I just want to know that at the end of the day the shows that beat me out did so because they are better shows and not just because they're co-owned by the network.[53]

More generally, owned-programming gets an inside track and is chosen when there are close calls.

> [I]t appears the incentives introduced into the program selection process by the repeal of the Fin-Syn rules have clearly affected the program selection process within broadcast networks. Specifically, the networks have an incentive to

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50 Asch, Peter and Rosalind Senaca, *Government and the Marketplace* (Dryden Press, Chicago: 1985), p. 248.
51 Einstein, p. 194-195.
52 Einstein, p. 217.
53 Bielby and Bielby, p. 581.

select programs produced in-house because of both financial and political reasons.[54]

[I] is important to note here that internally produced programming has the so-called home court advantage when it comes to being selected for the prime-time schedule.... 'If you put the network person in charge of both sides of the fence... It's impossible to ask the network person to have that much objectivity.[55]

Owned programming is given better time slots.

What is less known is that the networks are selling time periods, giving the best time slots on the schedule to those who make the best deal with the network.[56]

Owned programming is kept on the air longer.

Shows are also being maintained on the schedule for longer than they might be if the network did not have an ownership interest in the show.[57]

Owned programming clogs syndication.

A new issue has arisen in the syndication market that is adversely affecting producers to the benefit of the networks and their parent companies. Due to increased vertical integration, more and more companies are selling programs within their own company rather than going out into the marketplace to sell a show. For instance, a network that has its own production company will sell a hit show to its cable network at a below-market rate without opening the show to bidding by other outlets, cable or broadcast. Though this is very lucrative for the company, it is detrimental to the profit participants in the show—the producers, the actors and so forth. If the vertically integrated company sells the show internally, it is at a heavily discounted price, which means that the profit participants are cheated out of their rightfully earned money. By selling internally, the companies have almost created a new form of warehousing. Rather than keeping a show off the market, they are keeping the show off the market to competitors.[58]

The pattern of acquisition of shows and movies discussed in the previous chapter also suggests that when the oligopolists are not self-supplying, they engage in reciprocal dealing,

[54] Einstein, pp. 180-181.
[55] Einstein, p. 187.
[56] Einstein, p. 217.
[57] Einstein, p. 192.
[58] Einstein, pp. 198-199.

buying shows from one another. Interviews with independent producers conducted in preparing this study indicate that, with the vertical integration of studios into the core of the oligopoly, the problem afflicts the movie segment as well. The field is simply not level.

The interviews with independent movie producers suggest that the problems that afflict independents in syndication are somewhat different for producers of series and movies. The literature on independent producers of series shows that when independents were squeezed out of the prime time series market, they simply did not have product to sell into syndication, since they were literally put out of business. To some extent, producers of movies were similarly affected, since they did not have larger budget movies to sell into syndication, though they managed to remain in the movie business. Their theatrical releases were squeezed in the syndication space as the vertically integrated entities came to dominate syndication. The squeeze was two-pronged: they found it more difficult to get placement and the license fees and other terms deteriorated.

MONOPSONY POWER

The final area of concern identified in the analytic framework is the exercise of monopsony power. The gatekeeper problem is at the core of monopsony power concerns in the video content industry.[59] The harm in the exercise of monopsony power is the reduction of prices paid to suppliers and therefore a reduction of the quantity or quality of the product supplied.

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[59] Curtin, John J., Daniel L. Goldberg and Daniel S. Savrin, "The EC's Rejection of the Kesko/Tuko Merger: Leading the Way to the Application of a 'Gatekeeper' Analysis of Retailer Market Power Under U.S. Antitrust Law," 40 *B.C. L. Rev.* 537 (1999).

> By reducing its demand for a product, a monopsonist can force suppliers to sell to it at a lower price than would prevail in a competitive market... If the price is suppressed they will reduce output to a level that once again equals their marginal costs. In any event, both price and output will fall below the competitive level when the buyer is a monopsonist. Some productive assets will be assigned to products that would have been the supplier's second choice in a competitive market. As a result, monopsony allocates resources inefficiently just as monopoly does.[60]

This problem is evident in the TV video space as well. Broadcasters have the leverage to extract equity shares for shows not developed internally.

> [I] in recent years, the networks seem to have refined their strategy even further – recognizing that when series with high potential do appear from outside producers, they can use their market power to extract an ownership stake after the pilot has been produced.
>
> Secondarily, if the show is not internally produced, then the ability to have equity ownership in an externally produced show is expected for inclusion on the prime-time schedule.[61]
>
> Even shows in which the networks did not originally have an interest have had their financing restructured to allow the network to become a financial partner for a show to stay on air, particularly in the ever-important fifth year.... "'Shakedown is probably too strong a word, but they should not have the right to insist on ownership just to provide real estate on the airwaves.'"
>
> Giving a piece of the show to the network has become a normal way of doing business since the repeal of the Fin-Syn rules, because access to the airwaves depends on giving the networks a financial interest in the program. Sometimes these requirements are subtle, like requesting that a producer create their show with their studio's production facilities, and sometimes they are quite blatant – your money or your show.[62]
>
> Of even greater concern to these producers than the perceived favoritism towards in-house production and joint ventures is an increasingly common practice by the networks of commissioning pilots from independent producers

[60] Hovenkamp, Herbert, *The Law of Antitrust: An Integrated Handbook,* Hornbook Series (West Group, St. Paul, 2000), p. 14.
[61] Einstein, pp. 180-181.
[62] Einstein, p. 192.

> then demanding a financial stake as a condition of picking up a series for the prime time schedule.[63]
>
> Networks gain market power to meddle with the content offered by independents.
>
> The argument being advanced here is that the increase in in-house production following the demise of the Fin-Syn Rules created a conflict of interest as business executives from the networks are placed in a position to meddle in the creative process. Under the Fin-Syn Rules, it is argued that independent producers and those affiliated with the major studios were insulated from this kind of interference.[64]

Interviews with the independent film producers underscore the problem of monopsony power. The pervasive control over distribution channels on TV allows the integrated firms to dictate terms and conditions that squeeze the independents. These include license fees that do not cover the costs, given the quality that is demanded, extremely long license periods, and claims to back end-rights – home video, foreign sales and digital distribution -- that limit the ability of independents to make up for the inadequate license fees. The exercise of this monoposony power has gone so far as to allow the buyers to repurpose content to "higher" value" distribution channels without additional compensation for the independent producers. By taking a product that was purchased at terms and conditions designed for a lower value outlet and re-using it on a much higher value outlet, the vertically integrated company extracts much greater value (profit), without compensating the producer.

This exercise of monopsony power is akin to a practice that the vertically integrated companies had applied in the series space. In that space, the vertically integrated firms take a high value product and sell it at very low prices to a lower value outlet, in essence under stating the value of the product, to which independent participants might have a claim.

[63] Bielby and Bielby, p. 581.
[64] Beilby and Bielby, p. 580.

> A new issue has arisen in the syndication market that is adversely affecting producers to the benefit of the networks and their parent companies. Due to increased vertical integration, more and more companies are selling programs within their own company rather than going out into the marketplace to sell a show. For instance, a network that has its own production company will sell a hit show to its cable network at a below market rate without opening the show to bidding by other outlets, cable or broadcast. Though this is very lucrative for the company, it is detrimental to the profit participants in a show – the producers, the actors and so forth.[65]

It should be evident from these examples that the existence of multiple cable outlets does not alter the already restricted television landscape because the networks have captured a substantial hold over the most important cable networks.

> One way that networks are ensuring a faster return on investment is by having a secondary distribution channel usually in the form of a general entertainment cable channel. These channels are used as a secondary outlet through which they can distribute their programs.... Each of these networks present programming on the broadcast network that is then re-presented (or repurposed) on the secondary outlet. This will lead to more redundant programming and less new content through more outlets. Networks are also making their prime time programming available through video-on-demand and DVD collections.[66]

> Another increasingly popular business strategy implemented by the big four and emerging networks also offsets the impact of expanding channels of distribution. "Repurposing" involves exhibiting each episode of a series on an affiliated broadcast or cable network immediately after the initial network broadcast.[67]

[65] Epstein, pp. 198-199.
[66] Einstein, pp. 218-219, on the latter point Einstein cited Adalian, 2002.
[67] Beilby and Bielby, p. 592.

VI. THE DEBATE OVER QUALITY

QUALITATIVE OBSERVATIONS

The question of the relationship between vertical integration and declining quality has been hotly debated. The exercise of monopsony power is clearly affecting the structure of the industry. Two effects have been noted.

First, the number of entities engaged in the process has been reduced sharply because the distribution of risk and rewards has been shifted in favor of the networks.

> [T]he statistical patterns summarized above include instances in which the networks have used their enhanced market power to negotiate ownership shares in series pilots brought to them by outside suppliers. In these situations, the program supplier, not the network, absorbs development costs, while the network acquires a share of the back end profits if the series eventually becomes a hit and goes into syndication. From the program suppliers' perspective, the costs of development for new series remain the same, but to reach the prime-time schedule, the supplier has to agree to forgo a share of the future revenues. According to some in the industry, this revenue squeeze on independent program suppliers is the primary reason that a number of them have exited the business of prime-time series development.[68]

> So far, the most visible impact of deregulation has been a reduction in the number of organizational settings in which those who create television series are employed, and an increase in corporate control over the circumstances under which they practice their craft.[69]

The second effect is to eliminate the creative tension that once existed between the producer and the distributor of product.

> Vertical integration is seen as eliminating a valuable step in the development process. First, developing programming is a creative process. When one entity created the programming and another would select it, the two companies could argue and disagree and out of those discussions, the show would often be improved... [T]he process did favor internal shows and eliminated much of the

[68] Beilby and Bielby, p. 590.
[69] Beilby and Bielby, p. 593.

development process altogether. Producers also stated that this process was detrimental to the overall quality of network programming. [70]

One aspect of the debate over quality that is intriguing but little studied is the potential relationship between integration, declining quality and declining ratings. As Bielby and Bielby note:

> In 1999, *Advertising Age* editorialized that ABC was "auctioning" its most desirable prime-time time slot to the program supplier willing to give the network a financial stake, part of a trend that is making it "increasingly clear the broadcast networks are more interested in financial deals than putting the best shows they can find on the air." The trade publication warned that the ratings decline experienced by the networks would accelerate if "financial packages rather than program quality determine what gets on the schedule."[71]

The ratings decline certainly did continue, as integrated ownership of programming increased. As is frequently the case in this sector, many other things were changing that could account for the decline in ratings, but the correlation is notable.

Waterman sees some evidence of the latter effect on the studio side of the business.

> [E]xcessive movie budgets and an over reliance on sequels or derivative movies have also been associated unfavorably with conglomerate organization and the mentality of the top executive in charge.[72]

Waterman also notes that the claimed efficiency benefits of conglomeration have come into question.

> When merger plans are announced, industry analysts often cite efficiencies, such as workforce combinations, or marketing advantages, such as the ability to cross-promote movies using television, magazines or other media assets also owned by the conglomerate. Also commonly mentioned are the advantages of vertical integration, such as the ownership of television or cable networks that can serve as guaranteed outlets for movies produced by the conglomerate's studio branch. A related benefit is the ability to consolidate exploitation of a single story idea or character through books, magazines, television shoes, music publishing, Internet web sites, or other media within a single

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[70] Einstein, p. 194-195.
[71] Bielby and Bielby, p. 581.
[72] Waterman, p. 30.

corporation. The economic advantages of such operating efficiencies (often called economies of scope) are plausible. However, real multimedia exploitation within the same conglomerate is apparently infrequent and other efficiency claims have come into recent disrepute – notably in the cases of AOL-Time Warner and the ABC-Disney mergers.[73]

What we may be left with are the market power advantages of a tight oligopoly in the video entertainment space, which do not yield efficiency gains while imposing a heavy price in terms of diversity and quality.

QUANTITATIVE MEASURES OF QUALITY

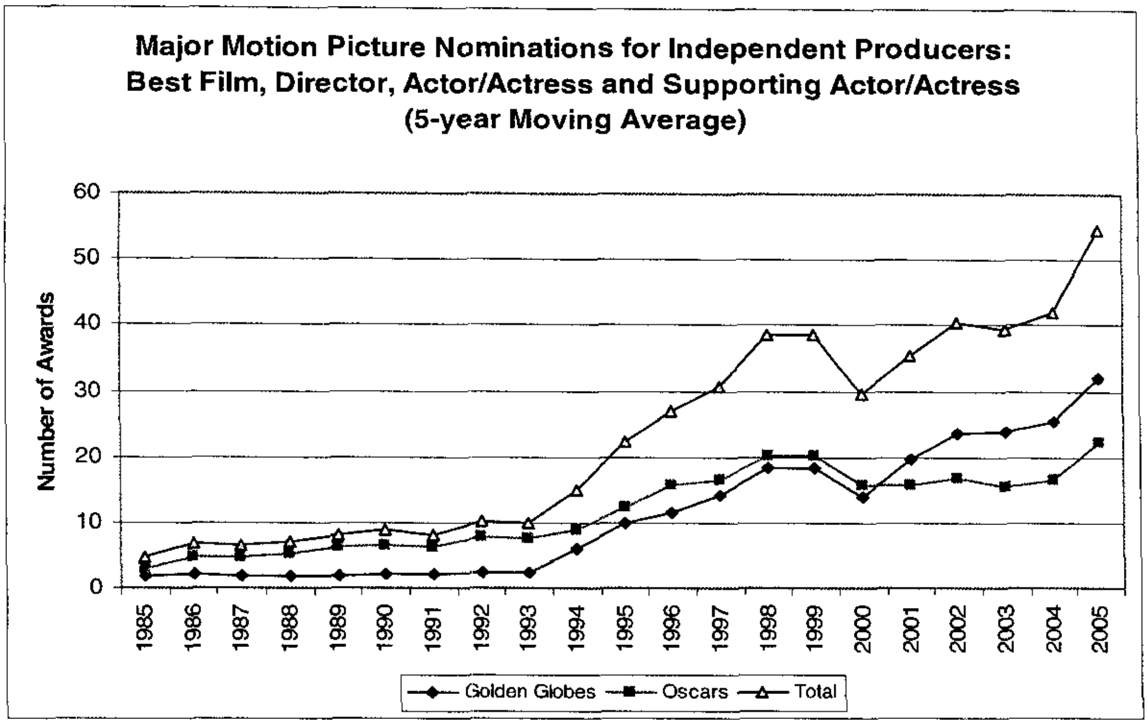
Claims that programming decisions reflect the efficient choice of the best available product are difficult to support in light of this description of the changes in behavior as well as the patterns in the data. These changes and patterns are more consistent with the argument that the vertically integrated oligopoly favors it own content and prefers to deal within the oligopoly.

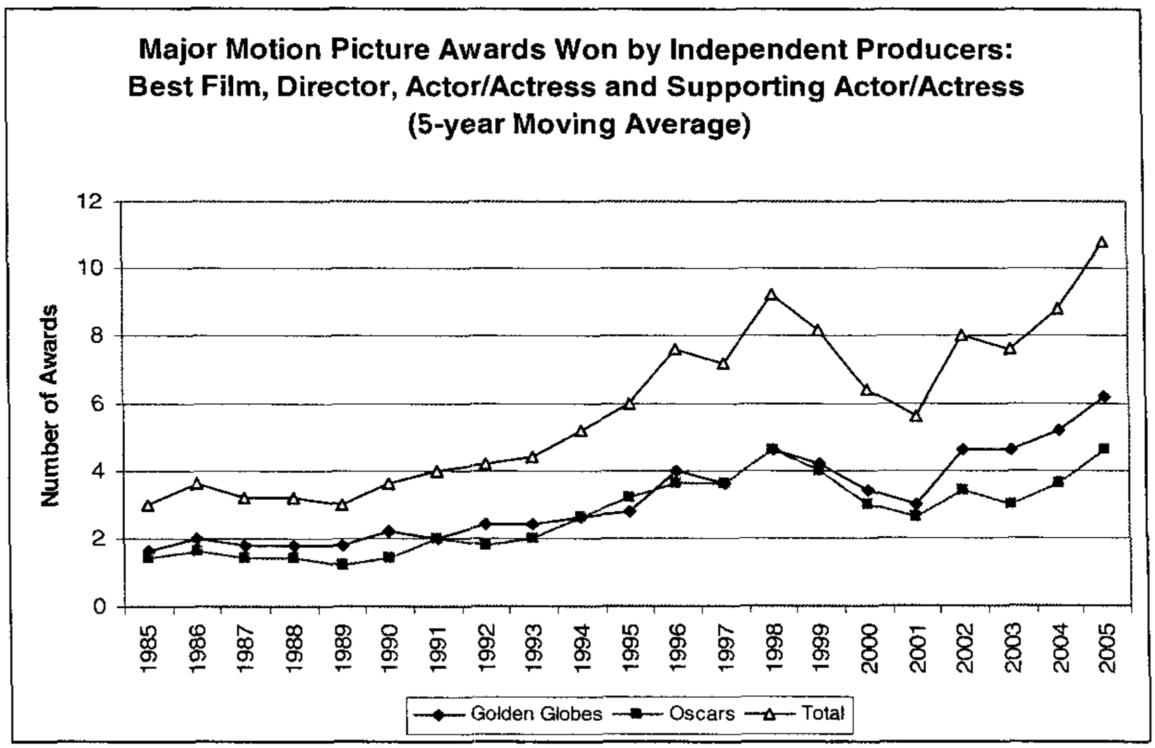
Movies

Objective measures of quality in product in the entertainment space are notoriously difficult to come by. In the movie space, analysts frequently turn to the annual awards ceremonies. The Oscars and Golden Globe Awards contradict the claim that independents suffered some sort of collapse in the 1990s. In fact, their share of awards has been constant, if not rising (see Exhibits VI-1 and VI-2).

[73] Waterman, p. 30; Peltier, Stephanie, "Mergers and Acquisitions in the Media Industries: Were Failures Predictable," *Journal of Media Economics,* 17(4), 2004.

Exhibit VI-1:
Major Categories, Golden Globes and Oscars: Majors v. Independents





Source: Box Office Mojo.com